



Alliance of Western Milk Producers

Representing California's dairy cooperatives and their producer-owners since 1991

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May 10, 2005

Mr. Dave Ikari
Dairy Marketing Branch
California Department of Food & Agriculture
1220 N Street
Sacramento, CA 95814

Subject: Post hearing brief on Class 1 hearing held May 3, 2005

Dear Mr..Ikari:

The Alliance of Western Milk Producers appreciates the opportunity to submit this post-hearing brief. Rather than reiterate and reinforce the points made in our direct testimony, this post-hearing brief will respond to issues raised at the hearing by other witness' testimony. Since the panel asked literally no questions of the various witnesses, all we have to comment on is the direct testimony given. We also question how the Department can come up with a fair and reasoned decision given that no cross examination of the witnesses occurred.

Why the Dairy Institute proposal should be rejected

First and foremost, the Dairy Institute's testimony wants the Department to accept its conclusion that the Secretary must give equal weight to all the declared intentions of the State Legislature. We would argue that there is a priority to the legislation passed by the Legislature. That is, each section added to the code builds on and clarifies what the State Legislature intends.

Section 62062.1 was passed by the Legislature well after all of the other sections of the Food & Agriculture Code referenced by the Department were enacted. They certainly were reviewed by the Legislative Council of the State Legislature as well as the agriculture committee staffs of the Assembly and Senate. In addition, the Department can be assured that the Dairy Institute raised all of the issues it raises in its testimony when the legislation that put Section 62062.1 in the code was heard the Legislature's ag committees. The State Legislature saw fit to make Section 62062.1 part of the Food & Agriculture code in spite these issues being raised by the Institute at that time.

In its direct testimony the Dairy Institute tries to give credence to seven reasons why current formulas fail to meet statutory criteria.

- I. Class prices no longer bear an economically sound and reasonable relationship to each other.*

To briefly repeat the Alliance's direct testimony, the data does not bear out this assumption. All class prices are based on the same commodity market values. The CME cheddar cheese and

DAIRY PRODUCT CONSUMPTION AND DEMAND

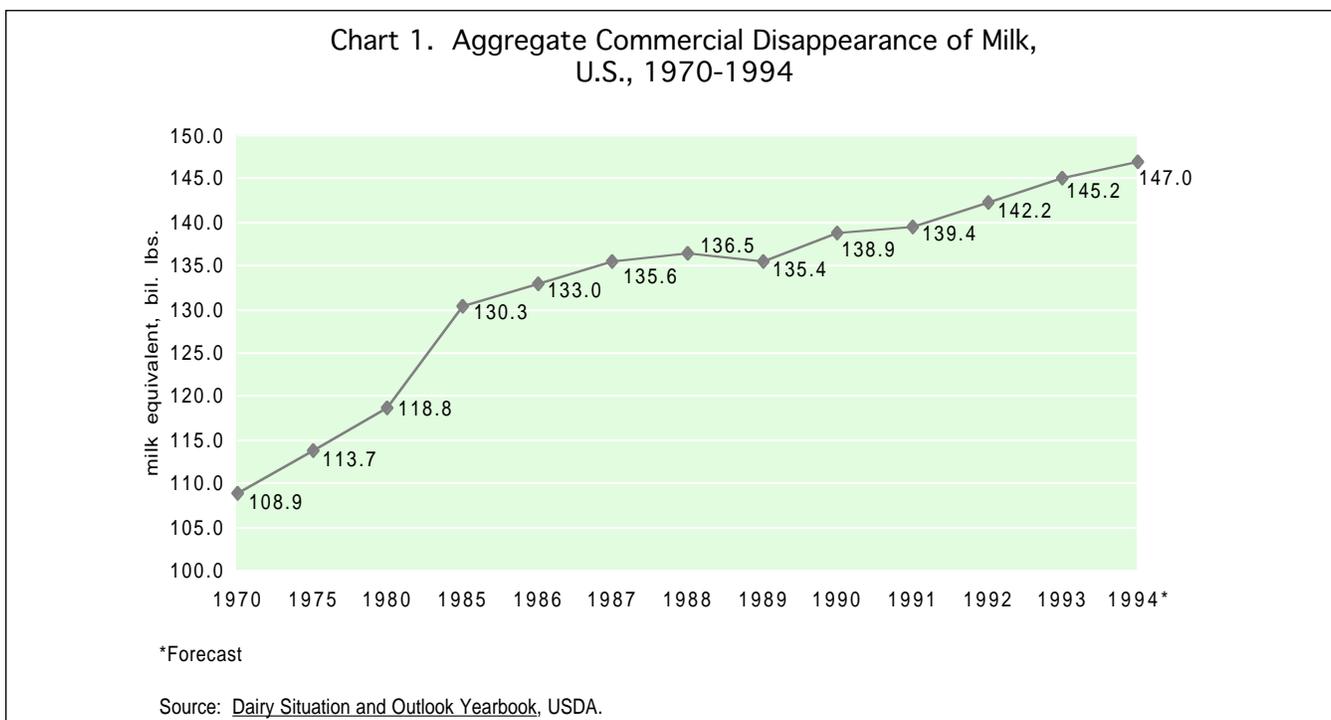
*Robert E. Jacobson and Joe L. Outlaw**

The 153 billion pounds of milk produced in 1994 marks the United States as the largest milk producing country on the planet. The ability to market its production through commercial channels continues to be a major industry concern. Trends in the consumption and sales of dairy products and factors affecting demand are the subjects of this paper. Other leaflets in this series focusing on different dimensions of consumption and demand include dairy promotion programs (Leaflet P-12); use of government stocks in export and domestic markets (Leaflet P-4); and export market potential (Leaflet P-11).

Aggregate Commercial Demand

As the data in Chart 1 indicate, commercial demand for milk and dairy products increased by 22 percent, from 118.8 billion pounds to 145.2 billion pounds, from 1980 to 1993. Part of the growth was due to population, but per capita increases in dairy product consumption have also been notable.

Demand data are reported on a milk equivalent (m.e.) basis. Milk equivalent refers to the amount of cow's milk required in the processing of the many dairy products reflected in the per capita consumption series. For example, the milk equivalent factor for one pound



*The authors are, respectively, Emeritus Professor in the Department of Agricultural Economics and Rural Sociology at The Ohio State University, and Assistant Research Scientist in the Department of Agricultural Economics at Texas A&M University.

of butter is 21.8—it requires the fat from 21.8 pounds of milk to produce one pound of butter. Milk equivalent data are sometimes criticized because they over-emphasize the impact of changes in demand for higher fat products. An alternative demand measure that is often used, especially for fluid milk products, is product pounds. Product pounds is the specific measure used for individual dairy products.

Aggregate annual demand is a function of population change and per capita consumption change. On July 1, 1993, the population of the United States was an estimated 258.8 million people. Over the last decade, U.S. resident population has been increasing by about 2 1/4 million persons per year, or by about 1 percent per year. It is therefore expected that aggregate commercial demand should increase by nearly 1 percent annually simply due to population growth. Obviously, any time annual increases in demand are over 1 percent, it means that per capita consumption has also been increasing.

Factors affecting per capita consumption in the 1980-1994 period include declining real retail prices, growing disposable family income, low unemployment, and effective promotion programs. Increased consumption has occurred despite reduced demand for

full fat formulations of dairy products; so the milkfat based milk equivalent disappearance figure is biased downward. Cheese sales continue to be strong. Fluid sales were up slightly. Substantial decreases in butter prices have brought some strength to the butter market in 1993 and 1994.

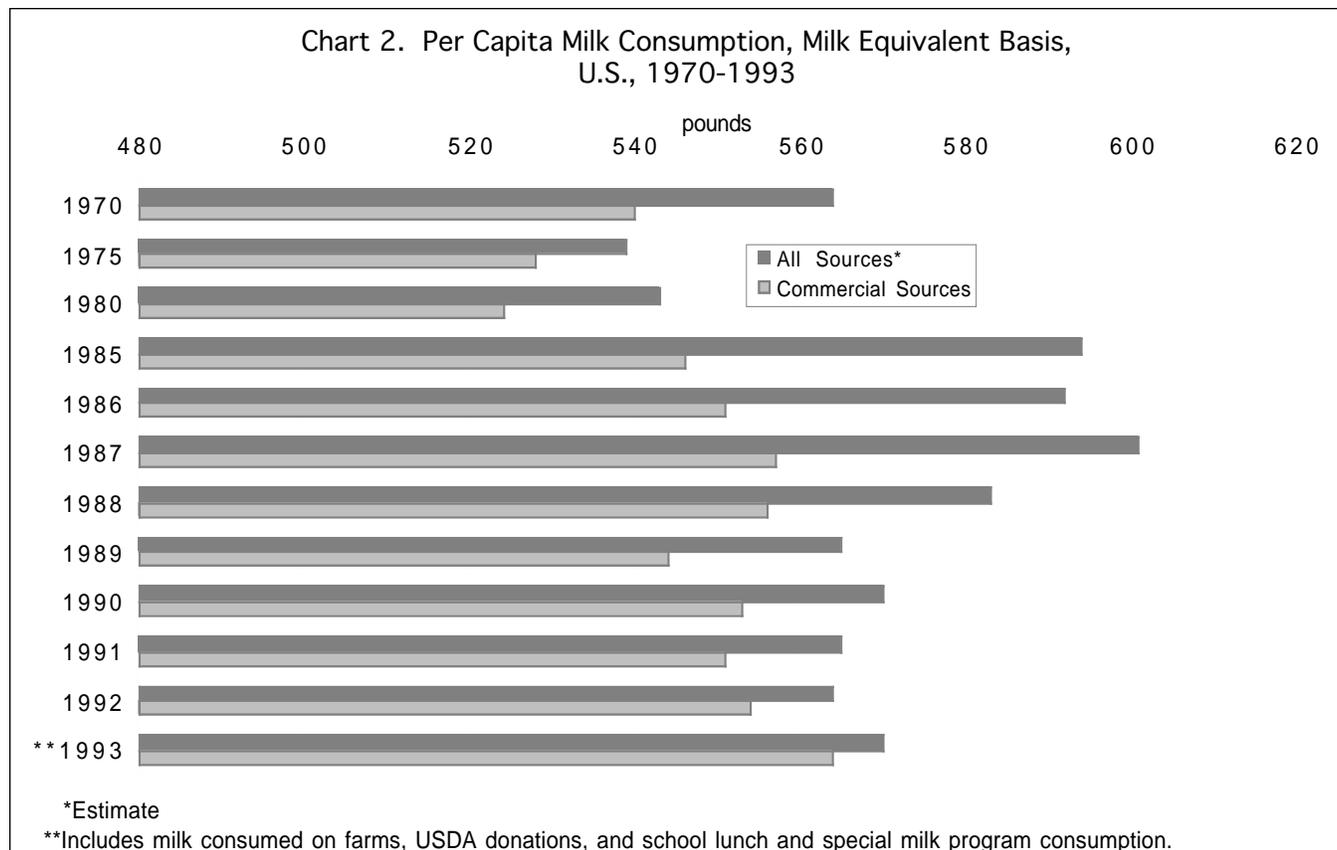
Per Capita Consumption Versus Demand

Chart 2 shows per capita consumption of milk and dairy products on a milk equivalent basis from 1970 to 1993. The All Sources value includes milk consumed on farms, USDA donations, and School Lunch and Special Milk Program (i.e., subsidized) consumption.

As the data indicate, per capita consumption has made a remarkable recovery in the 1980 through 1993 period from barely over 500 pounds milk equivalent (commercial sources) in the early 1980s to about 570 pounds at the present time. Two obvious questions occur from inspecting these data:

- What factors explain the increase?
- Will per capita consumption continue to increase in the future?

The differences in per capita commercial demand and per capita consumption show up almost exclusively in butter data and cheese data. For example, in 1990, per



capita consumption of butter was 4.4 pounds while per capita commercial demand was 3.7 pounds. Similarly, per capita consumption of “hard” cheese was 24.7 pounds while per capita commercial demand was 24.9 pounds. This means that donations programs apply primarily to butter (see Leaflet P-4).

Per capita commercial demand estimates for sixteen different dairy products for seven separate years during the 1975-1992 period are shown in Table 1. The individual product data reflect different situations, with the most notable increases recorded in the lowfat and skim fluid product and cheese categories.

Table 1. Per Capita Consumption of Milk and Dairy Products, Product Pounds Unless Indicated, United States, 1975 to 1992

Product	1975	1978	1981	1984	1987	1990	1992
Whole Milk	181.3	161.0	140.0	126.8	111.9	90.3	84.1
Lowfat Milk	61.3	73.5	82.2	88.8	100.6	108.3	106.3
Skim Milk	11.5	11.5	11.3	11.6	14.0	22.9	25.0
Cream	3.4	3.3	3.5	4.0	4.7	4.6	4.8
Yogurt	2.1	2.5	2.5	3.7	4.4	4.1	4.3
Eggnog	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Butter	4.7	4.4	4.2	4.9	4.7	4.4	4.2
Sour Cream	1.6	1.7	1.8	2.2	2.4	2.5	2.7
Cheese	14.3	16.8	18.2	21.5	24.1	24.6	26.0
Cottage Cheese	4.6	4.7	4.3	4.1	3.9	3.4	3.1
Evaporated/ Condensed Milk	8.7	7.5	7.2	7.4	8.0	7.9	8.5
Ice Cream	18.6	17.6	17.4	18.2	18.4	15.8	16.4
Sherbet	1.5	1.4	1.3	1.3	1.2	1.2	1.3
Ice Milk	7.6	7.7	7.0	7.0	7.4	7.7	7.1
Other Frozen							
Dairy Products	1.0	0.7	0.8	0.8	1.2	3.7	4.4
Nonfat Dry Milk	3.3	3.1	2.1	2.5	2.5	2.9	2.7
Other Dry Milk Products	2.5	2.9	3.3	3.8	4.3	4.6	4.4
Total - Milk Equivalent	539.1	544.3	540.6	581.9	601.3	569.7	564.6

Source: Putnam, Judith Jones and Jan E. Allshouse, *Food Consumption, Prices, and Expenditures, 1970-92*, ERS-USDA, Statistical Bulletin No. 867, September 1993.

Fluid Milk Sales

While sales of fluid milk products per capita on a product weight basis reflected a slight downward drift in the 1970s, they subsequently have been relatively stable at about 225 pounds. Lower whole milk consumption essentially has been balanced by more lowfat and skim milk consumption. USDA estimates indicate that in 1986, for the first time ever, per capita consumption of lowfat milk including skim milk (113.6 pounds), exceeded per capita consumption of whole milk (109.9 pounds). However, these fluid milk consumption data need to be scrutinized more closely because of sales shifts within the fluid category.

The federal order program reports sales data for ten different fluid milk products. These values are reported in terms of changing shares of the fluid milk market, compare 1993 sales with 1980 sales, and are

reported in Table 2. For example, whole milk sales accounted for 58.7 percent of fluid milk sales in 1980, but only 34.9 percent in 1993.

Table 2. Fluid Milk Sales, All Federal Order Milk Markets, 1980 and 1993

	1980 40.85 bil. lbs.	1993 44.70 bil. lbs.
Whole Milk	58.7%	34.9%
Whole Flow Milk	2.0	1.5
2% Lowfat Plain	19.1	34.2
2% Lowfat Fort.	4.6	2.8
1% Lowfat Plain	4.5	7.6
1% Lowfat Fort.	1.9	1.0
	30.1%	45.6%
Skim - Plain	3.2	10.9
Skim - Fort.	1.5	1.8
	4.7%	12.7%
Flavored Lowfat/Skim	2.8	3.9
Buttermilk	1.7	1.5
Total	100.0%	100.0%

Source: Federal Milk Market Order Annual Statistics for 1980 and 1993.

A number of points stand out from an inspection of the total in Table 2:

- Combined sales of class I products as identified in the table increased by almost 10 percent to 44.7 billion pounds from 1980 to 1993.
- Whole milk (plain) underwent a major decrease and accounted for only 34.9 percent of the fluid milk market in 1993.
- Combined plain lowfat and skim sales increased from 34.8 percent of the fluid milk market in 1980 to 58.3 percent in 1993.
- Plain lowfat milk (2 percent and 1 percent), was 41.8 percent of fluid sales in 1993. Most of the plain lowfat milk (82 percent) was identified as 2 percent; the remainder of the plain lowfat milk was labeled as a 1 percent milkfat product.
- A small portion (8 percent) of the 2 percent lowfat milk was fortified with additional solids-not-fat. About 12 percent of the 1 percent lowfat milk had added solids-not-fat. The proportions of both 2 percent and 1 percent lowfat milk that were fortified with added solids-not-fat declined substantially from 1980 through 1993.
- The skim milk share of the fluid milk market tripled from 1980 to 1993, from 4.7 percent to 12.7 percent. Solids-not-fat fortification of skim milk declined, and in 1993, 86% of all skim milk was plain (non-fortified).
- Flavored milk products accounted for 5.4 percent of the fluid milk market in 1993, a slight

increase from 1980. In 1993, almost three-fourths of flavored milk products were either a lowfat or skim product; only one-fourth were whole milk products.

In reviewing these observations in conjunction with the per capita estimates in Table 1, some general conclusions can be reached.

- The shift away from whole milk to lowfat milk continues without interruption, probably both due mostly to milk-fat/cholesterol reasons.
- Except for California with its different standards of identity, fortification of lowfat and skim milk has decreased since the 1960s and now accounts for only small shares of those markets. Higher nonfat dry milk prices and consumer acceptance of non-fortified milk has discouraged fortification in the past twenty years. Greater calcium awareness could help reverse the fortification downtrend. (See Leaflet P-13 for a discussion of the minimum nonfat standards issue.)
- Flavored milks are fairly small shares of the fluid milk market, and per capita consumption of flavored milks shows only modest strength.

- Skim milk has a small but rapidly growing share of fluid milk sales.

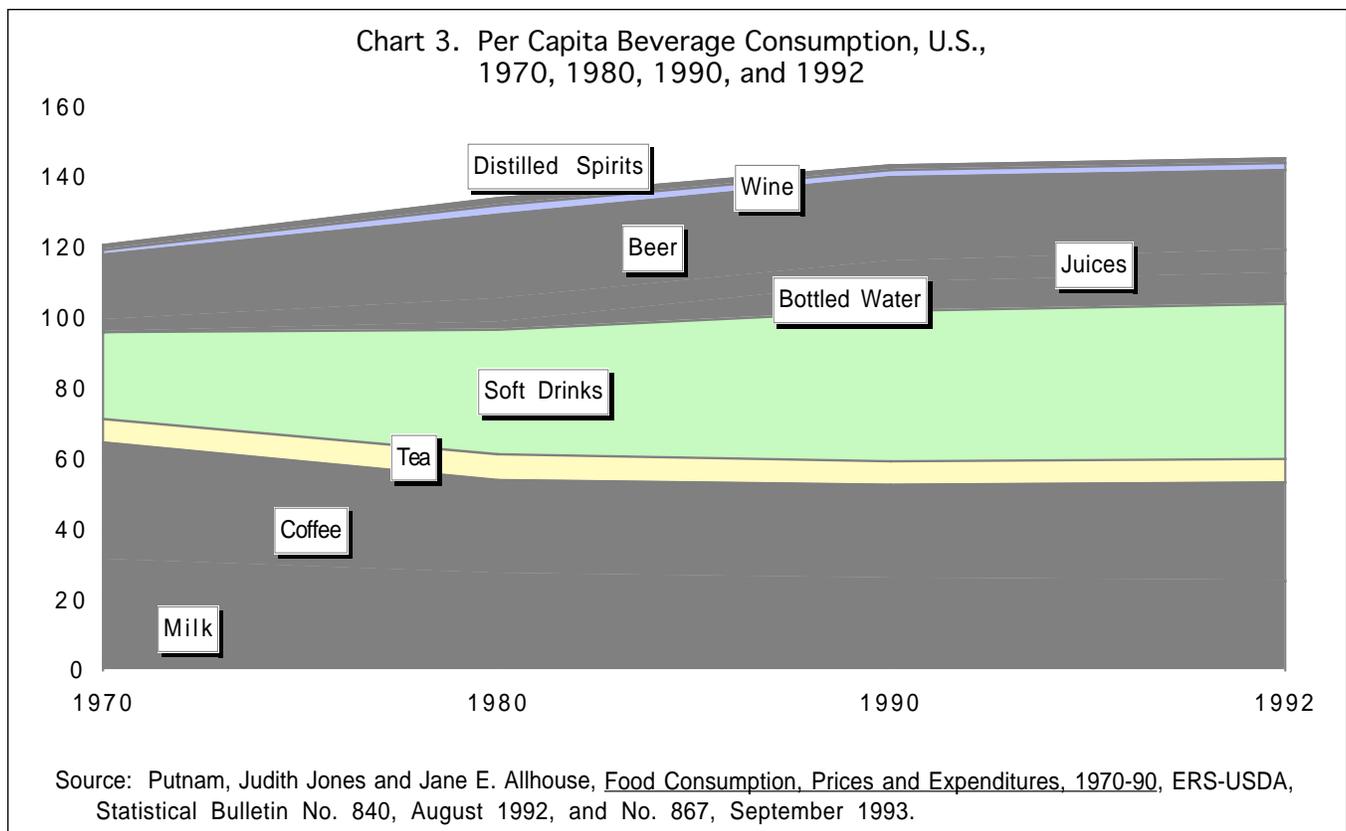
Fluid Products as Part of a Broader Beverage Market

Chart 3 contains per capita beverage consumption estimates for nine beverages for 1970, 1980, 1990, and 1992. Consumption of most beverages (excluding milk and coffee) has trended upward in recent decades. In 1970, total per capita beverage consumption was 120.9 gallons and it was estimated at 145.3 gallons in 1992.

Total beverage consumption (for the nine identified beverages) is up by nearly 25 gallons per capita over the twenty-two year period. Across all beverages in the 1970-1992 period, coffee and milk have been the big losers. The remarkable surge in soft drink consumption dominates the beverage consumption picture. An interesting phenomena that has occurred recently is that milk processing plants have begun to process other products such as fruit juices in an effort to capitalize on expanding demand for these products and keep plant capacity fully utilized.

Butter

In 1957 per capita margarine consumption exceeded per capita butter consumption for the first time.



Since about 1970, the consumption relationship between these two products has been relatively stable at 11 pounds per capita margarine consumption and 4 pounds per capita butter consumption. Blends of vegetable oil and milkfat are becoming a more significant factor in the “spread” market but market data on this particular item are not publicly available. Some observers believe that the blend market will increase the total market for milkfat, but this has yet to be demonstrated.

With respect to butter, only 30 percent is consumed at home. The other 70 percent is consumed as an ingredient and in the away-from-home market. Additionally, government programs such as the Temporary Emergency Food Assistance Program have made substantial butter donations in recent years, which have displaced margarine, and not butter sales (see Leaflet P-4).

Cheese

Per capita cheese consumption has more than doubled since 1970, reaching an estimated 26.0 pounds in 1992. Growth has been primarily in the away-from-home market and as ingredients in the processed foods market. Currently, an estimated 38 percent of cheese is consumed at home, 39 percent away from home, and 23 percent as ingredients in processed foods. Cheese demand has been somewhat vulnerable to government donations programs. USDA has estimated that each 100 pounds of cheese donations displaces about 35 pounds of commercial purchases.

Imitation cheese (made with dairy proteins such as casein and non-dairy oils) became a measurable factor in the marketplace in the 1980s. Such products may equal as much as 7 to 8 percent of the cheese market. Most imitation cheese is used by food processors, particularly on frozen pizza. However, the imitation cheese market has not grown as rapidly as early projections suggested. Relatively strong world prices for casein in the United States have removed some of the cost advantage associated with imitation cheese.

Frozen Dairy Products

Frozen dairy product consumption, including ice cream, ice milk, and sherbet, has held at relatively strong and constant levels in recent years at approximately 6 gallons per capita annually. Per capita consumption of other frozen dairy products, especially frozen yogurt, have increased dramatically in recent years.

Cream

Per capita consumption of cream products in the United States generally held in the 11-13 pound range annually in the 1940s and early 1950s. Due to quality problems and relatively higher prices, cream products became a natural target for substitution. By 1970, per capita cream consumption (including sour cream) had dropped to under 5.5 pounds. Substitution was seen in both the light cream (coffee cream) market and in the heavy cream (whipping cream) market. However, real cream products have made a significant comeback in the marketplace since 1984, probably because coffee cream is now available in long shelf-life forms (ultra pasteurized); also, changes in cream pricing (class II) have resulted in relatively lower prices.

Milkfat Substitutes

The food industry is involved in continuing research and development efforts aimed at finding milkfat substitutes that diminish or avoid the saturated fat-cholesterol issues associated with animal fats. In 1990, the Food and Drug Administration approved one of these fat substitutes, Simplese, as a “Generally Regarded As Safe” product. Simplese is a natural product of egg (white) proteins or milk (albumin) proteins. Simplese is made by using a patented heating and blending process called microparticulation. The protein is made into tiny ground particles that provide a creamy mouth feel. One gram of Simplese is 1.3 calories as contrasted with one gram of fat at 9 calories. When heated, Simplese, as a natural protein, will gel. Therefore it has some usage limitations. However, it has a wide range of potential uses in refrigerated and frozen dairy products as well as other food products. The market at this juncture has not adopted Simplese as widely as earlier projections had suggested. Other fat substitutes, several of which utilize whey proteins, continue to be in development stages.

Factors Affecting Demand for Milk and Dairy Products

Higher consumer income and declining retail prices for milk and dairy products relative to other foods have caused most of the increase in per capita consumption that has occurred since 1980. The 22 percent increase in total consumption from 1980 through 1993 reflects a combination of the increases in per capita consumption and the growth in population. Factors other than income and price have affected per capita consumption changes. These factors include advertising, concerns regarding

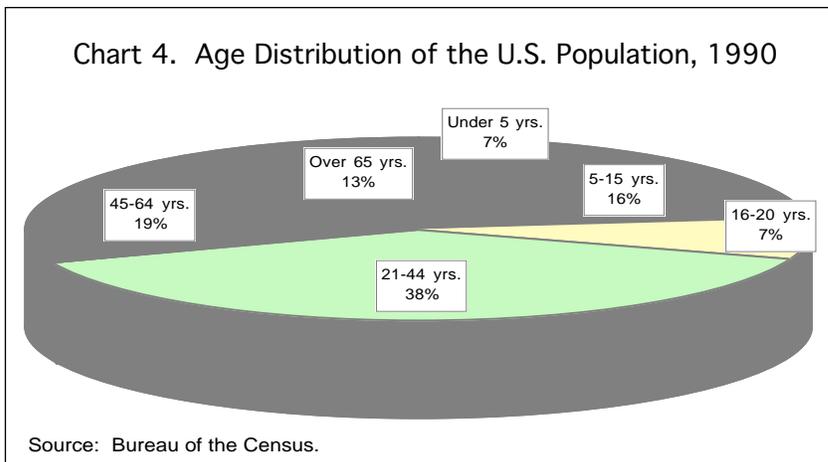
health and nutrition, changes in demographics, and levels of government donations. However, these other factors are secondary to the price-income effects.

A recent USDA analysis reported a number of price and income elasticities. The price relationships all showed the expected effects (higher prices, lower consumption, etc.) and were relatively consistent with prior studies. The income effects were strong and positive for products such as cheese but negative for fluid milk and nonfat dry milk (Table 3). The USDA report cautions that these income elasticities should be interpreted conditionally because it is difficult to separate the effects of income from trend effects. The fluid milk income elasticity with its negative sign, for example, may come closer to reflecting changes in tastes and preferences over time. However, the elasticity measures of about -0.3 for fluid milk and cheese are generally believed to be accurate.

	Price Elasticity	Income Elasticity	At Home Consumption Income Elasticity
Total Dairy Products	-0.31	0.18	0.14
Fluid Milk	-0.26	-0.22	0.02
Cheese	-0.33	0.59	0.32
Butter	-0.17	0.02	0.35
Evap., Cond., Dry Milk	-0.83	-0.27	-0.12
Frozen Dairy Products	-0.12	0.01	0.21

Source: Haidacher, R.C., J. R. Blaylock, and L. H. Myers. Consumer Demand for Dairy Products. ERS-USDA, Agricultural Economic Report No. 586, March 1988, p. 7.

One issue that has emerged from the USDA study concerns a finding of the relative unimportance of advertising as a factor affecting demand. Olan Forker of Cornell University has responded to the USDA report on the advertising issue as follows: "...enough research has been completed to indicate that generic advertising can increase dairy product sales.... The results of the fluid milk models developed here at Cornell and by others for UDIA and the National Dairy Board can be validated and imply that the fluid milk advertising at current levels is worthwhile. The results of the cheese models are inconclusive. The calcium model does not provide a measure of volume yet...."



This issue is discussed more completely in Leaflet P-12 of this series.

The primary demographic factors that have been identified as having significant influences on milk and dairy product consumption include age, household size, race, and region. Age distribution appears to be the primary change factor as we look ahead. A decreasing proportion of our population will be in age groups under forty as we approach the year 2000. Chart 4 reports the age distribution of the United States population by age groups for 1990. The median age of the U.S. population moves to new record highs each year. In 1983, it was 30.9 years; it was an estimated 33.1 years in 1990; and is projected to reach 36.3 years at the turn of the century. Milk is generally viewed as a food of children and young adults. Dairy product advertising can be expected to place increased emphasis on the importance of consuming dairy products at older ages.

The 1987-1988 USDA Nationwide Food Consumption Survey measured many relationships including weekly per person dairy expenditures by household type, family income, race, and geographic region. The average weekly expenditures for dairy products by household type are indicated in Table 4. Households with male and female heads spent approximately 10 percent more per week on dairy products than female head households. This is possibly due to the fact that single females with children have significantly less income—about half that of other households. Income quintile (Table 5) appears to have a large impact on the amount of money spent on dairy products. In every category, the higher the income, the higher the weekly expenditures on dairy products.

Table 4. Average Weekly Dollar Value of Food Used at Home by Household Type

	HOUSEHOLD TYPE			All
	Female Head with Children	Male & Female Head with Children	Other	
Dairy Products	\$2.78	\$3.05	\$3.21	\$3.07
Fresh Milk	\$1.34	\$1.43	\$1.38	\$1.40
Frozen Desserts	\$0.29	\$0.39	\$0.45	\$0.40
Cheese	\$0.74	\$0.88	\$1.08	\$0.93

Source: Lutz, S. M., D. M. Smallwood, J. R. Blaylock, and M. Y. Hama. "Changes in Food Consumption and Expenditures in American Households During the 1980s," USDA, ERS, HNIS, Statistical Bulletin 849, December 1992.

Table 5. Average Weekly Dollar Value of Food Used at Home by Income Quintile

	INCOME QUINTILE				
	First	Second	Third	Fourth	Fifth
Dairy Products	\$2.69	\$2.80	\$3.05	\$3.38	\$3.59
Fresh Milk	\$1.32	\$1.35	\$1.40	\$1.46	\$1.49
Frozen Desserts	\$0.25	\$0.33	\$0.44	\$0.44	\$0.53
Cheese	\$0.66	\$0.78	\$0.95	\$1.04	\$1.24

Source: Lutz, S. M., D. M. Smallwood, J. R. Blaylock, and M. Y. Hama. "Changes in Food Consumption and Expenditures in American Households During the 1980s," USDA, ERS, HNIS, Statistical Bulletin 849, December 1992.

The USDA survey revealed that weekly dairy expenditures for Whites averaged \$3.25 (Chart 5). For Blacks, weekly dairy expenditures were 37 percent under that amount; and for non-White/non-Black racial groups, expenditures were 17 percent under that of Whites. This is not surprising due to the reported incidence of lactose intolerance among Blacks. Fairly modest changes in race distribution in the future, as the proportion of Whites decreases marginally, indicate that if current expenditure patterns hold, race will have a small but negative impact on consumption.

Region becomes another factor in demand prospects for milk and dairy products, particularly as the West and South are projected to have growing shares of the U.S. population compared to the Northeast and North Central regions. As reported in the Nationwide Food Consumption Survey, per person expenditures for all dairy products are highest in the Northeast and lowest in the South, but individual dairy products show substantial differences from this pattern. Chart 6 shows weekly dairy expenditures per person by region. Weekly per person expenditures for dairy products in the North Central, South, and West regions generally are below those in the Northeast.

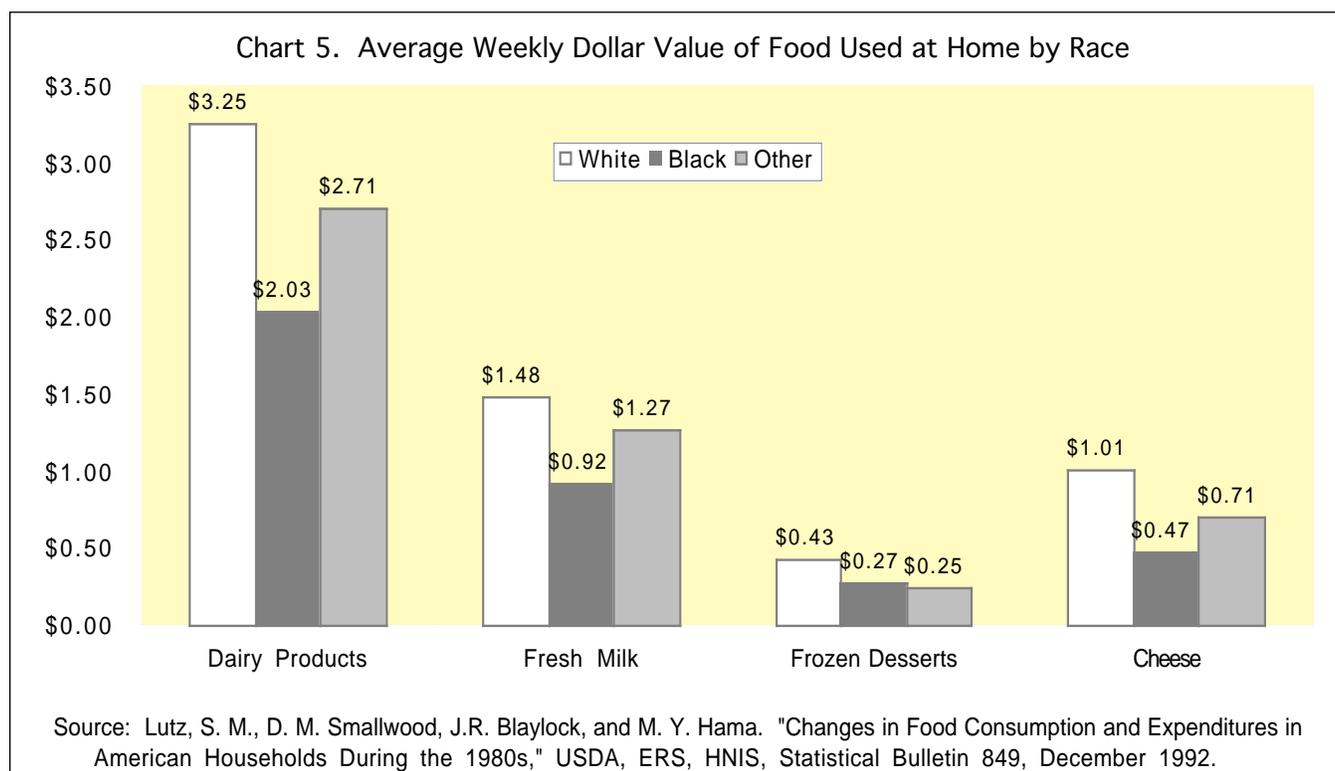
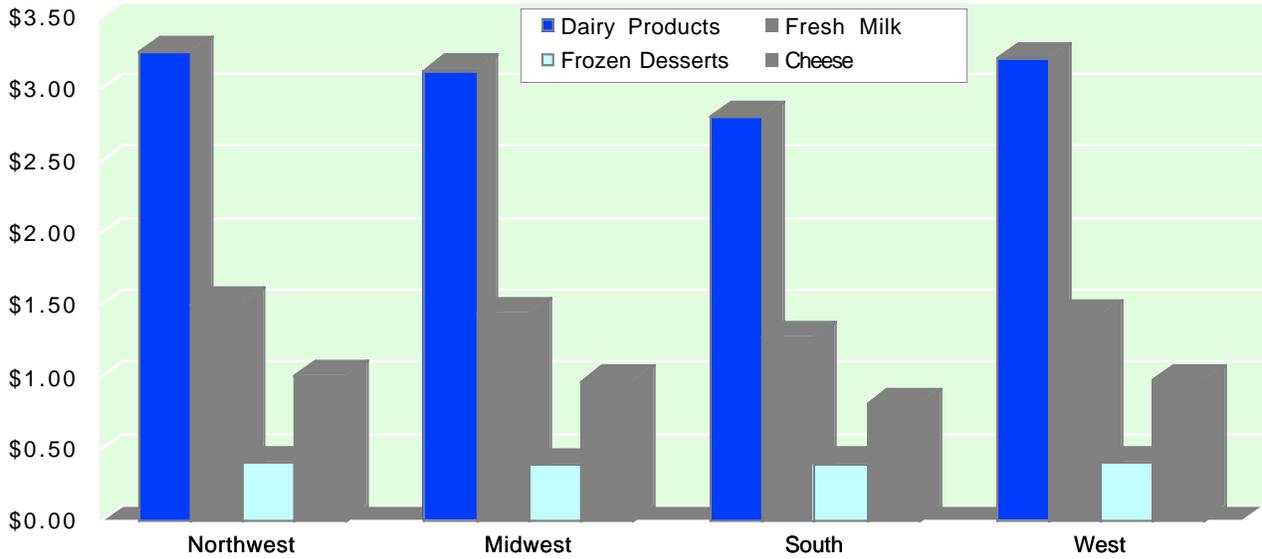


Chart 6. Average Weekly Dollar Value of Food Used at Home, by Region



Source: Lutz, S. M., D. M. Smallwood, J. R. Blaylock, and M. Y. Hama. "Changes in Food Consumption and Expenditures in American Households During the 1980s," USDA, ERS, HNIS, Statistical Bulletin 849, December 1992.

In a recent report, the U.S. Department of Agriculture consolidated the demographic factors and made projections to 1990 and 2000 based on 1980 expenditure levels. These projections are reported in Table 6.

Demographic Factors	Milk and Cream	Cheese	Butter	Other Dairy Products	All Dairy Products
--percent changes in expenditures from 1980 levels--					
Age					
1990	-0.2	1.0	1.1	0.5	0.5
2000	-0.9	1.9	1.8	2.1	1.6
Region					
1990	-0.1	-0.2	-0.7	0.1	-0.1
2000	-0.2	-0.4	-1.3	0.3	-0.1
Race					
1990	-0.3	-0.5	-0.2	-0.2	-0.3
2000	-0.5	-0.1	-0.3	-0.4	-0.6
Total					
1990	-0.6	0.3	0.2	0.4	0.1
2000	-1.6	1.4	0.2	2.0	0.9

Source: Haidacher, Richard, and James Blaylock, "Why Has Dairy Product Consumption Increased?" *National Food Review*, ERS-USDA, Vol. 11, Issue 4, October-December 1988, p. 31.

It is evident from the data that age is the dominant demographic factor affecting expenditures for dairy products through this next decade. While most of the region and race coefficients carry negative signs, the age signs are mostly positive and, more important, the total for all dairy products indicates that weekly expenditures per person will be up by 0.1% in 1990 and up by 0.9 percent by 2000.

Summary and Conclusions

While debate continues about how much weight to give the various factors affecting demand, it is evident that the generally accepted factors continue to include price, income, price of substitutes, advertising, and demographics. The short review of these factors implies slow steady growth in domestic consumption over the next decade.

butter market prices are the basis for Class 1, 2, 3, 4a and 4b prices. The differences in values used in the formulas are the result of the time frames during which the data is collected. The time frame difference exists because the processors that the Dairy Institute represents want as much advance pricing for Class 1, 2 and 3 as possible.

The only way a more sound and reasonable price relationship might be achieved between class prices is to reduce the difference between the class 1, 2 and 3 time frame (26th through 10th) and the class 4a and 4b time frame (26th through the 25th). The Institute could have suggested that the class 1, 2 and 3 price time frame be changed to the 26th through the 17th. However, the Dairy Institute opposes such an approach as stated on page 19 of its testimony in its objections to the California Dairy Campaign proposal. Apparently, the Institute feels strongly that advance pricing is much more important than economically sound and reasonable relationships between class prices.

Instead, the Institute it says that the proofs of its first point are:

1. Reductions in Class 1 utilization
2. Low cost of production
3. Too much price enhancement on top of what it calls cost-based differential justification.

In an attempt to show that California's reduction in Class 1 utilization is greater than in the rest of the country, the Institute offers Table 1 on page 4 of its testimony. However, what the Institute didn't show was the milk pooled on the orders. The table below was put together by the Alliance from the "Federal Milk Order Market Statistics Annual Summary" for the years 2000 through 2004. What it shows is the Class 1 utilization in each of these marketing areas is more a function to declining milk production in some areas and the depooling of manufacturing milk in other areas.

(million pounds)	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Northeast	23,970	24,557	25,358	24,038	22,670
Appalachian	6,318	6,673	6,706	6,315	6,202
Southeast	7,487	7,769	7,927	7,071	7,164
Florida	2,867	2,772	2,693	2,833	2,873
Mideast	14,181	17,229	17,739	15,750	15,940
Upper Midwest	23,415	20,062	20,307	17,018	17,302
Central	16,037	17,836	18,700	14,411	11,589
Southwest	8,712	8,604	9,714	9,174	8,791
Arizona-Las Vegas	3,110	2,956	3,027	3,061	2,901
Western	4,048	4,677	5,552	4,573	1,096
Pacific Northwest	6,776	7,088	7,824	6,336	6,518

Even more revealing is what milk production has done in the US during the above time frame:

Annual Milk Production, 2000-2004

<u>State</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>% Change 2000- 2004</u>
KS	1,540	1,610	2,030	2,130	2,216	43.9%
OR	1,640	1,717	2,093	2,177	2,270	38.4%
NM	5,236	5,561	6,316	6,666	6,710	28.2%
ID	7,223	7,757	8,155	8,774	9,093	25.9%
IN	2,419	2,567	2,658	2,939	2,962	22.4%
AZ	3,033	3,085	3,430	3,552	3,646	20.2%
CO	1,924	1,970	2,159	2,153	2,184	13.5%
CA	32,245	33,217	35,065	35,437	36,465	13.1%
AK	13	14	18	17	15	12.3%
MI	5,705	5,870	6,120	6,375	6,315	10.7%
NV	476	485	501	485	509	6.9%
TX	5,743	5,107	5,300	5,630	6,009	4.6%
MT	338	346	341	345	347	2.7%
OH	4,461	4,295	4,475	4,490	4,560	2.2%
GA	1,433	1,433	1,470	1,444	1,416	-1.2%
NY	11,921	11,780	12,218	11,952	11,650	-2.3%
IA	3,934	3,785	3,804	3,810	3,843	-2.3%
WA	5,593	5,514	5,620	5,581	5,416	-3.2%
NH	312	322	328	305	302	-3.2%
VT	2,683	2,669	2,703	2,637	2,584	-3.7%
OK	1,314	1,325	1,307	1,312	1,263	-3.9%
UT	1,687	1,635	1,666	1,622	1,609	-4.6%
WI	23,259	22,199	22,074	22,266	22,085	-5.0%
IL	2,094	2,020	2,051	2,047	1,978	-5.5%
ME	668	654	656	624	612	-8.4%
FL	2,463	2,411	2,308	2,161	2,253	-8.5%
SD	1,474	1,370	1,289	1,330	1,347	-8.6%
VA	1,900	1,885	1,891	1,731	1,731	-8.9%
PA	11,156	10,849	10,775	10,338	10,062	-9.8%
DE	146	150	150	132	128	-12.7%
MD	1,351	1,294	1,301	1,215	1,162	-14.0%
MN	9,493	8,812	8,458	8,258	8,102	-14.7%
NC	1,189	1,154	1,137	1,044	1,006	-15.4%
KY	1,695	1,660	1,614	1,465	1,423	-16.0%
NE	1,255	1,166	1,167	1,129	1,051	-16.3%

<u>State</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>% Change</u>
WY	76	63	63	54	63	-16.6%
TN	1,405	1,335	1,315	1,205	1,155	-17.8%
NJ	244	233	236	216	200	-18.0%
MO	2,258	1,949	1,946	1,886	1,847	-18.2%
CT	480	456	447	413	392	-18.3%
MA	376	357	361	332	296	-21.3%
SC	370	367	364	318	287	-22.4%
ND	686	644	593	520	526	-23.3%
WV	265	249	243	216	194	-26.8%
AL	348	300	277	252	245	-29.6%
MS	541	497	478	423	379	-29.9%
RI	28	23	23	22	20	-30.0%
HI	116	106	97	92	81	-30.6%
LA	698	632	579	519	479	-31.4%
AR	485	432	393	354	318	-34.4%
	167,392	165,331	170,063	170,395	170,805	

Just twelve of the 50 states have increased milk production over the past five years. None of them are in the Northeast, Appalachian, Southeast, Florida, or Upper Midwest marketing areas. In fact, of the 12, only Ohio, Michigan and Indiana are east of the Mississippi River.

The Institute's cost of production is a non-argument as well. Basically they are saying that because the cost of production in California is low, based on the analysis that they used, the Class 1 price should be lower. As the Alliance showed in its testimony, in only two of the last five years did the California overbase price exceed the California cost of production.

Also USDA mailbox price data compiled by the Alliance shows that the low cost of production states – California, Idaho, New Mexico – also have the lowest mailbox prices.

Mailbox Milk Prices	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Northeast Federal Milk				
Order	\$14.94	\$11.88	\$12.54	\$16.32
Appalachian States	\$15.67	\$12.60	\$12.87	\$16.21
Southeast States	\$16.02	\$13.18	\$13.49	\$16.81
Florida	\$17.58	\$15.23	\$15.12	\$18.26
Ohio	\$14.83	\$11.90	\$12.35	\$15.87
Michigan	\$14.61	\$11.70	\$12.06	\$15.57
Wisconsin	\$14.68	\$12.02	\$12.64	\$16.56
Minnesota	\$14.58	\$11.83	\$12.66	\$16.29
Corn Belt States	\$14.35	\$11.64	\$11.83	\$14.80
Western Texas	\$14.78	\$12.01	\$12.08	\$15.17

New Mexico	\$13.84	\$11.07	\$11.14	\$14.09
Idaho	\$13.52	\$10.91	\$11.48	\$13.06
Utah	\$13.62	\$10.74	\$11.12	\$12.91
Northwest States	\$14.23	\$11.57	\$11.35	\$14.70
All Federal Order Areas	\$14.78	\$11.91	\$12.34	\$15.93
California	\$13.89	\$10.99	\$11.60	\$14.72

Finally, the mumbo-jumbo the Dairy Institute has in its testimony about its implied differential not being cost justified. The Institute talks about the cost of producing Grade A milk today compared to manufacturing milk and so on.

The fact is, the surrounding markets no longer are basing the differentials on what it costs to produce Grade A milk over Grade B milk. The federal orders now use what the Institute calls a transshipment or transportation model to arrive at Class 1 differentials. They point out that these models are an indicator of relative value across space. Put into plain English, the Cornell model used by USDA to establish Class 1 differentials was based on milk production distance from market areas. Clearly, this is an acceptable and economically sound method of determining the relative value of milk for Class 1 use.

In summary, the Institute's arguments that California's class prices are not economically sound or reasonable don't support that allegation.

II. Producer income is more than sufficient to generate an adequate supply of milk.

The Institute argues that per capita milk production is THE way to measure whether there is an adequate supply of milk for all uses. This theory ignores the fact that most dairy products produced in California are for a national market, not for local consumption like fluid milk. As Figure 3, page 11, in the Institute's testimony shows, a 22 states fall far below the national average of 582 pounds of milk production per capita and that the majority of states are below the average as well.

As the Alliance put forth in its testimony, a more accurate measure of the adequacy of the milk supply is commodity prices. In 2004, commodity prices, and therefore milk prices, reached record levels. If the supply of milk nationally was adequate this wouldn't have happened. Yes, if you look at the milk California produced versus the milk Californians consumed in various forms, it was more that adequate. However, if you consider that California sold almost no dairy products to the Commodity Credit Corporation in 2004 (and have not sold any in 2005), to say that the supply of milk was or is more than adequate is a misrepresentation of the true situation.

Institute's arguments III and IV try to make the case that consumers are burdened by high Class 1 prices. First of all, the average 2004 California Class 1 farm price in Southern California

(\$1.44) was less than the average 2004 Class 1 farm price in Phoenix (\$1.49) and Las Vegas (\$1.46).

Average retail whole milk prices for California cities compared cities in surrounding markets also show that it is not the farm price that is causing the burden:

	<u>Ave. 2004</u>
Los Angeles	\$3.06
Phoenix, AZ	\$3.44
Portland, OR	\$3.67
Seattle, WA	\$3.95
San Francisco	\$3.26
Sacramento	\$3.27

The Institute also tries to make the case that producers can become more productive while processors and retailers have reached physical limits with respect to productivity growth. That argument is just foolish. Dairy men have become more productive by making investments in genetics, feed, equipment and facilities. Certainly processors and retailers can make investments in equipment and people to increase productivity as well.

On page 15, under V, of the Institute's testimony it tries to convince the Department that producer organizations are saying that "reasonable" in Section 62062.1 means equal. None of the producer alternatives said that in their testimony and none of their proposals ask the Department to do that. Even in the example the Institute gives to try to prove this point, it talks about producers trying to get the Legislature to set the California Class 1 price at 10 cents less than the Class 1 prices in surrounding states when they were trying to pass Section 62062.1 language. Check the math, but 10 cents less isn't equal. However, contrary to the Institute's assertion on page 16 under this section, the Legislature did not mean "reasonable" in section 62062.1 to mean "one where the California Class 1 prices are significantly lower than those in surrounding state." To try to argue that is what the Legislature intended in passing section 62062.1 doesn't pass the laugh test.

A uniform price to handlers is another argument the Institute tries to make to justify a significantly lower Class 1 price to producers. Of course, because producer-handlers in California don't account to the pool on a limited amount of milk that they produce on their dairies and bottle, the Class 1 price on the 80% of the Class 1 market that they don't (and can't) supply should be reduced in a vain attempt to achieve a uniform price. A uniform Class 1 price between all handlers cannot be achieved unless classified pricing and pooling are done away with entirely.

The Alliance finds it fascinating that Dairy Institute members referenced the farm milk coming in from out-of-state as creating disorderly marketing when their own organization supports this disorderly practice.

It is also interesting that the Institute is asking the Department to reduce producer Class 1 prices to counter unregulated packaged fluid milk from coming into California. What is being proposed by the Institute will not really impact this situation. It is only through the legislative effort that producer organizations have been working with the Institute on for the past two years in Washington, DC, that this situation can truly be addressed.

Also, the Department must reject the Institute's accusation that the only reason that the Alliance filed an alternative proposal was to get the Secretary to take a neutral position. By making this statement the Institute is assuming that the Alliance's intent in filing an alternative proposal was to have the Secretary do nothing. This is absolutely and unequivocally not the case.

The members of the Alliance firmly believe that Section 62062.1 requires that the Department increase Class 1 prices as it has proposed. To do nothing or to lower California's Class 1 prices would not be following the Legislature's clear directive in that statute.

And, finally, the Alliance was asked to provide data that supports its statement that the reason California's fluid milk consumption was less than the national average is the racial make-up of California's population. Attached is a copy of the study "Dairy Product Consumption and Demand" by Robert E. Jacobson and Joe L. Outlaw. On page 7 of the study is a chart the shows the weekly average expenditures on various dairy products by racial grouping. As can be seen, the expenditure on fluid milk for whites is \$1.48, for blacks \$0.92 and for other nonwhites \$1.27. This data clearly supports the Alliance statement that the difference in California's racial make up compared to the US accounts in no small part for the difference in consumption of fluid milk.

The Alliance urges CDFA to reject the Institute's proposal and adopt the Alliance alternative in its place.

Respectfully submitted,

A handwritten signature in black ink that reads "Jim Tillison". The signature is written in a cursive, flowing style.

James E. Tillison, CEO
Alliance of Western Milk Producers